First Exam
November 9, 2006

Answer in blue book. Use the point values as a guide to how extensively you should answer each question, and budget your time accordingly. There are 100 points total.

1. (20 points) Write a short essay answering either one (just one – your choice) of the following questions:
   a. What, if anything, can and should be done to reduce the United States trade deficit?
   b. Should the United States and Europe put pressure on China to increase the value of its currency?

2. (20 points) Write a short paragraph explaining the meaning and importance each of any two (your choice) of the following three terms and its role in the institutions of the international economy:
   a. Trade promotion authority
   b. Dollar shortage / dollar glut
   c. Most favored nation

3. (45 points) Consider a small country that initially imports 2 million bushels of potatoes, per year, under free trade at a world price of $5 per bushel. A large number of domestic firms also produce potatoes (identical to imported ones) and sell them on the domestic market.
   a. Show, using an appropriate model, who in this country will gain and who will lose if it now levies a 10% ad valorem tariff on imports of potatoes.
   b. If you were quantify (in dollars) these gains and losses and add them up, would the country as a whole gain, lose, or be unaffected by this tariff?
   c. How, if at all, would your answers to the above be changed if
      i. The policy was a specific tariff of $.50 per bushel, rather than an ad valorem tariff.
      ii. Demanders were completely unwilling ever to pay more than $5 per bushel for potatoes, viewing them as perfect substitutes for turnips that continue to be available for $5 per bushel.
      iii. The country were not small, but instead faced a perfectly inelastic (i.e., vertical) supply of imported potatoes from abroad. (Let demand behavior be back to normal in this case; i.e., no turnips.)
4. (15 points) Without doing any formal analysis, for each of the following statements, explain in words why it is true or false:

a. An import quota provides a greater benefit to an import-competing domestic monopolist than would be provided by a tariff that would lead to the same quantity of imports.

b. A voluntary export restraint lowers the welfare of the importing country as a whole more than would a tariff that provides the same benefit to import-competing domestic producers.

c. An export subsidy improves the exporting country’s terms of trade.